STATE OF CALIFORNIA

Report to the California State Legislature

PROPERTY TAX APPORTIONMENTS

Calendar Year 2001

KATHLEEN CONNELL
California State Controller

February 2002

February 5, 2002

**To the Members of the State Legislature
and the Citizens of California:**

I am pleased to present the *Property Tax Apportionments* report for calendar year 2001. This report, prepared pursuant to *Government Code* Section 12468, is intended to help mitigate problems associated with the counties' apportionment and allocation of property tax revenues.

The audits completed by the State Controller's Office in 2001 found the audited counties to be generally in compliance with the legal requirements for the allocation of property tax revenues. However, this report notes specific problem areas relative to individual counties.

I hope you find the report informative and useful for future policy decisions.

Sincerely,

KATHLEEN CONNELL
State Controller

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Overview

Introduction

This report presents the results of 12 audits of county property tax apportionments and allocations completed by the State Controller's Office in calendar year 2001. The counties audited were: Del Norte, Fresno, Los Angeles, Madera, Monterey, Sacramento, San Bernardino, San Mateo, Shasta, Trinity, Tulare, and Tuolumne. *Government Code* Section 12468 requires that such audits be conducted periodically for each county according to a prescribed schedule based on county population. The purpose of the audits is to help mitigate problems associated with property tax apportionment and allocation.

Except for the findings and recommendations noted in the Appendix, all audited counties complied with the requirements for the apportionment and allocation of property tax revenues.

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local agencies with a property tax base that would grow as assessed property values increase. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8, which established the method of allocating property taxes for fiscal year 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

Property tax revenues that local governments receive each fiscal year are based on the amount received the prior year plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the *Revenue and Taxation Code*.

The AB 8 process involved several steps, including the transfer of revenues from schools to local agencies and the development of the tax rate area annual tax increment growth factors (ATI factors), which determine the amount of property tax revenues allocated to each entity (local agency and school). The total amount allocated to each entity is then divided by the total amount to be allocated to all entities to determine the AB 8 factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities using the revenue amounts established in the prior year. These amounts are adjusted for growth annually using ATI factors.

Subsequent legislation has removed revenues generated by unitary and operating nonunitary property from the AB 8 system. This revenue is now allocated and apportioned under a separate system.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are

required to transfer a portion of their property tax revenues to the ERAF. The fund is subsequently allocated and apportioned by the county auditor according to instructions received from the local superintendent of schools or chancellor of community colleges.

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if unpaid, can be satisfied by the sale of the property by the tax collector.

- *Unsecured Roll*—Property that, in the opinion of the assessor, does not constitute sufficient "permanence" or have other intrinsic qualities to guarantee payment of taxes levied against it.

- *State-Assessed Roll*—Utility properties, composed of unitary and nonunitary value, assessed by the State Board of Equalization.

- *Supplemental Roll*—Property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

Audit Program

The property tax audit program began on July 1, 1986, under *Revenue and Taxation Code* Section 95.6 (now *Government Code* Section 12468). The statute mandates that the State Controller periodically perform audits of the allocation and apportionment of property tax revenues by counties and make specific recommendations to counties concerning their property tax administration. However, the State Controller's authority to compel resolution of its audit findings is limited to those findings involving an overpayment of state funds.

Overpayment of state general fund money is recoverable by the State under several provisions of law (e.g., *Education Code* Section 42237.7 et seq., and *Government Code* Section 12420 et seq.). In addition, the State Controller has broad authority to recover overpayments made from the State Treasury. If an audit finds overpayment of state funds, and the state agency that made or authorized the payment does not seek repayment, the State Controller's Office is authorized to pursue recovery through a variety of means (e.g., *Government Code* Sections 12418 and 12419.5). The specific remedy employed by the State Controller's Office depends on the facts and circumstances of each situation.

In order to carry out the mandated duties of the State Controller, the State Controller's Office developed and implemented a comprehensive audit program that includes, but is not limited to, a detailed analysis of past and current requirements of property tax laws and an examination of property tax records, processes, and systems at the county level.

The State Controller's Office property tax apportionment audits have identified and aided in the correction of property tax underpayments to public schools. The underallocation of property taxes by individual counties to their public schools results in a corresponding overpayment of state funds to those schools by the same amount. This, in turn, causes public schools in other counties to receive less state funding since the total funds available are limited. Subsequent legislation forgave some counties for underpayments to schools without requiring repayment or assessment of penalties. However, the legislation required that the cause of the underallocations, as identified by the audits, be corrected.

Audit Scope

Each audit encompasses an evaluation of a county's property tax apportionment methodology, allocation procedures, and compliance with applicable laws and regulations. The auditors used procedures considered necessary to provide a basis for reporting on the areas examined. In conducting the audits, the auditors focused on the following areas to determine if:

- The apportionment and allocation of annual tax increments was in accordance with *Revenue and Taxation Code* Sections 96-96.5;

- The methodology for redevelopment agencies' base-year calculations and apportionment and allocation of annual tax increments was in accordance with *Revenue and Taxation Code* Sections 96.4 and 96.6 and *Health and Safety Code* Sections 33670 through 33679;

- The effect of jurisdictional changes on base-year tax revenues and annual tax increments was in accordance with *Revenue and Taxation Code* Section 99;

- The apportionment and allocation of property tax revenues from supplemental assessments was in accordance with *Revenue and Taxation Code* Sections 75.60 through 75.71;

- The apportionment and allocation of state-assessed unitary and operating nonunitary property taxes was in accordance with *Revenue and Taxation Code* Section 100;

- The computation and apportionment of property tax revenues to low- and no-tax cities was in accordance with *Revenue and Taxation Code* Section 98;

- The computation and collection of local jurisdictions' property tax administrative costs was in accordance with *Revenue and Taxation Code* Sections 95.2 and 95.3;

- The computation and apportionment of property tax revenues to the ERAF was in accordance with *Revenue and Taxation Code* Sections 97 through 97.3; and

- For eligible counties, the computation of the county credit against the county's ERAF shift was in accordance with *Revenue and Taxation Code* Sections 97.3(a)(5) and 97.36.

Conclusion

The State Controller's Office believes that the property tax allocation and apportionment system is generally operating as intended. In the interest of efficiency and cost control for both the counties and the State, the summary findings and recommendations in this report are submitted to assist in initiating changes that will help improve the system.

Summary of Findings and Recommendations

Introduction

Except for the findings and recommendations noted in the Appendix, the audit reports issued in 2001 indicated that the counties complied with the legal requirements for the apportionment and allocation of property tax revenues. However, problem areas were identified. The problems are described below. Recommendations to resolve the problems are included with the individual county findings in the Appendix.

Unresolved Prior Audit Findings

As part of the audit process, auditors review the prior audit report to determine issues that may require follow-up. Procedures are undertaken to determine whether previously noted findings have been resolved. Unresolved prior audit findings are restated in the current audit.

The State Controller's Office restated findings for three counties with unresolved prior audit findings.

Computation of Annual Tax Increment Factors

The *Revenue and Taxation Code* requires that each jurisdiction in a tax rate area (TRA) be allocated property tax revenues in an amount equal to the property tax revenues it was allocated in the prior fiscal year. The difference between this amount and the total amount of property tax assessed in the current year is known as the annual tax increment. The computation of the annual tax increment results in a percentage that is used to allocate growth in assessed valuation to local government jurisdictions and schools in a county from the base year forward. *Revenue and Taxation Code* Sections 96 through 96.5 prescribe this methodology. (Some exceptions to this allocation are contained in the *Revenue and Taxation Code* for specified TRAs.)

The State Controller's Office noted findings for three counties for this area.

- One county incorrectly transcribed the assessed valuation for three TRAs and allocation factors for several new TRAs.

- One county recomputed the annual tax increment factors for all jurisdictions for all TRAs each year.

- One county did not adjust the AB 8 base revenue correctly for the removal of the unitary and operating nonunitary base revenues.

Jurisdictional Changes

Revenue and Taxation Code Section 99 prescribes the procedures required to make adjustments for the apportionment and allocation of property taxes resulting from changes in jurisdictional controls or changes in responsibilities of local government agencies and schools. The statute requires specific documentation that takes into consideration services and responsibilities when changes occur.

The State Controller's Office noted a finding in one county for this area. The county, for some jurisdictional changes, did not transfer the assessed value from the old TRAs to the new TRAs when the new TRAs were formed.

Supplemental Property Tax Apportionments

When a revaluation of property occurs during the fiscal year due to changes in ownership or completion of new construction, supplemental taxes are usually levied on the property. *Revenue and Taxation Code* Sections 75.70, 75.71, and 100.2 provide for the apportionment and allocation of these supplemental taxes.

The State Controller's Office noted findings for two counties for this area:

- One county improperly excluded multi-county educational entities from the supplemental apportionment process.

- The other county incorrectly apportioned supplemental revenue because it removed the revenue applicable to a redevelopment agency twice.

Supplemental Property Tax Administrative Fees

Counties, upon the adoption of a method identifying the actual administrative costs associated with the supplemental roll, are allowed to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental taxes collected.

The State Controller's Office noted a finding in one county for this area. The county did not document the cost of billing, collecting, and apportioning supplemental taxes to justify the collection of the administrative fee.

Redevelopment Agencies

The legal requirements for the apportionment and allocation of property tax to redevelopment agencies are found in *Revenue and Taxation Code* Sections 96.4 and 96.6 and *Health and Safety Code* Sections 33670 through 33679. California community redevelopment law entitles a community redevelopment agency to all of the property tax revenue realized from growth in values since the redevelopment project's inception, with specified exceptions.

The State Controller's Office noted findings for one county for this area. The county has had a continuing problem identifying all unsecured parcels within redevelopment agency TRAs and transferring them to new TRAs when a redevelopment agency is created.

Unitary and Operating Nonunitary Property Taxes

The process for allocating and apportioning property taxes from certain railroad and utility companies functions through the unitary and operating nonunitary tax system employed by the State Board of Equalization. Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee." *Revenue and Taxation Code* Section 100 prescribes the procedures required to allocate unitary and operating nonunitary property taxes beginning in fiscal year (FY) 1988-89.

The State Controller's Office issued findings for six counties in this area:

- One county incorrectly computed unitary and operating nonunitary revenues in years when those revenues did not increase by more than 2% by using AB 8 apportionment factors.

- One county incorrectly computed unitary and operating nonunitary revenues in years when those revenues increased by more than 2% over the preceding year because the county excluded the Educational Revenue Augmentation Fund (ERAF) and redevelopment agencies from the computation.

- One county incorrectly computed unitary and operating nonunitary revenues in years when those revenues increased by more than 2% over the preceding year because the county excluded redevelopment agencies from the computation.

- One county incorrectly computed unitary and operating nonunitary revenues in years when those revenues increased by more than 2% over the preceding year because the county excluded the ERAF from the computation, distributed the revenue applicable to the Special District Augmentation Fund (SDAF) to all jurisdictions rather to the contributing agencies when the SDAF was dissolved, and computed the countywide average tax rate by including unsecured revenue in the formula.

- One county incorrectly computed unitary and operating nonunitary revenues in years when those revenues increased by more than 2% over the preceding year because the county failed to include all taxing jurisdictions including the ERAF.

- One county incorrectly computed unitary and operating nonunitary revenues because it excluded a redevelopment agency from the computation, used an incorrect levy percentage, used an incorrect assessed valuation, and used an incorrect methodology when revenues increased by more than 2% over the preceding year.

Property Tax Administrative Fees

Counties are allowed to collect from each appropriate jurisdiction that jurisdiction's share of the cost of assessing, collecting, and apportioning property taxes. *Revenue and Taxation Code* Section 95.3 prescribes the requirements for computing and allocating property tax administrative fees. The assessor, tax collector, and auditor generally incur county property tax administrative costs. The county is generally allowed to be reimbursed for these costs.

The State Controller's Office noted a finding in one county for this area. The county excluded the ERAF when determining the administrative allocation factors.

Educational Revenue Augmentation Fund

The legal requirements for the local agency shift of property tax revenues to the ERAF are found in *Revenue and Taxation Code* Sections 97 through 97.3. Beginning in FY 1992-93, each local agency was required to shift an amount of property tax revenues to the ERAF using formulas prescribed by the *Revenue and Taxation Code*. The property tax revenues in the ERAF are subsequently allocated to schools and community colleges using factors supplied by the county superintendent of schools or chancellor of the California community colleges.

Since the passage of the ERAF shift requirements, numerous bills have been enacted that affect the shift requirements for various local government agencies. One bill of particular interest was AB 1589 (Chapter 290, Statutes of 1997). This bill primarily addressed three areas related to the ERAF shift: (1) ERAF shift requirements for certain county fire funds for FY 1992-93 (*Revenue and Taxation Code* Section 97.2(c)(4)(B)); (2) a special provision for counties of the second class when computing the ERAF shift amount for county fire funds in FY 1993-94 (*Revenue and Taxation Code* Section 97.3(c)(4)(A)(I)); and (3) ERAF shift requirements for county libraries for FY 1994-95 and subsequent years. After the passage of AB 1589, the State Controller requested advice from the California Attorney General regarding the application of Chapter 290. The Attorney General responded in May 1998.

The Attorney General advised that the amendment to *Revenue and Taxation Code* Section 97.2(c)(4)(B) significantly narrowed the scope of the exemption granted by the code section and was to be given retroactive application. The result is that many counties and special fire protection districts that were able to claim an exemption under the section as it formerly read lost the exemption retroactive to FY 1992-93. Consequently, those counties and special districts were required to shift additional funds to the county ERAF.

In response to the advice by the Attorney General, and noting the severe fiscal impact the loss of the exemption would have on local government agencies, the State Controller recommended that legislation be considered to restore the exemption previously granted to fire protection districts and county fire funds that was lost as a result of Chapter 290. Subsequently, the Legislature enacted AB 417 (Chapter 464, Statutes of 1999), restoring the exemption to fire districts that had been lost after the passage of Chapter 290, Statutes of 1997.

The State Controller's Office issued findings for seven counties in this area.

- One county did not reverse the FY 1992-93 ERAF disaster relief credit in FY 1997-98 resulting in an underallocation to the ERAF.

- One county properly reversed the ERAF disaster relief credit but did not make corresponding adjustments to TRA factors to correct the growth portion of the adjustment and did not completely implement the requirements of AB 1589 (Chapter 290, Statutes of 1997.)

- One county improperly computed the ERAF shift, resulting in an undershift for the county, one city, and several special districts and an overshift for six cities and several other special districts.

- One county incorrectly computed the ERAF shift growth by excluding redevelopment agencies' pass through amounts from the growth factor in contributing agencies.

- One county did not compute ERAF growth when assessed valuation grew from the preceding year, resulting in an underallocation to the ERAF.

- One county incorrectly reversed the ERAF disaster relief credit, resulting in an overallocation to the ERAF.

- One county incorrectly computed the ERAF shift because the county did not correct base revenue and TRA factors as previous recommended by the Controller, incorrectly computed the FY 1993-94 ERAF shift, and did not carry the FY 1992-93 ERAF shift forward to subsequent years as required.

ERAF Shift Credit

Counties *Revenue and Taxation Code* Sections 97.3(a)(5) and 97.36 allow a credit against the county's required ERAF shift. Counties that first implement the alternative procedure for the distribution of property tax revenues authorized by Chapter 2 (commencing with Section 4701) of Part 8 during FY 1993-94, or a subsequent fiscal year, are allowed a credit against their required ERAF shift. The credit is limited to the amount of any increased revenues allocated to a "qualifying school entity" that would not have been allocated but for the implementation of the alternative procedure.

For purposes of determining the ERAF shift credit, the Legislature defined a qualifying school entity as a "school district, county office of education, or community college district that is not an excess tax school entity as defined in Section 95.1" (*Revenue and Taxation Code* Section 97.3[a][5]). Most counties, when computing the credit, instead used the definition of "school entity" contained in Section 95(f), which included the ERAF. The inclusion of the ERAF in the credit computation, in some instances, dramatically increased the credit. The State Controller's legal counsel opined that counties must use the definition of qualifying school entity when computing the credit. Noting the severe fiscal impact of this situation on many counties, the State Controller delayed proceeding on this matter until legislation could be introduced to revise the definition of

qualifying school entity. The Legislature subsequently enacted AB 838 (Chapter 649, Statutes of 1999), which included the ERAF as a qualifying school entity.

Chapter 649 also contained a special provision for counties of the sixteenth class. This provision allowed counties of the sixteenth class to compute the amount of the shift credit based upon their historical method of allocating property taxes.

The State Controller's Office issued findings for two counties in this area:

- One county understated its ERAF shift credit.

- One county used an improper date when computing the ERAF shift credit amount, resulting in an overstatement of the credit amount.

Appendix—Findings of Individual County Audits

Introduction

The findings and recommendations included in this appendix are presented as they were stated in the County Property Tax Apportionment and Allocation reports issued by the State Controller's Office (SCO) in calendar year 2001. Unless otherwise indicated, the counties agreed with the findings and recommendations. The findings and recommendations listed below are solely for the information and use of the California Legislature, the respective counties, the Department of Finance, and the SCO, and are not intended to be and should not be used by anyone other than those specified parties. This restriction is not intended to limit distribution of this report or the respective audit reports, which are a matter of public record.

Del Norte County (July 1, 1995, through June 30, 2000)

FINDING 1— Incorrectly calculated and distributed ATI

The county incorrectly transcribed the assessed valuation for three TRAs and allocation factors for several new TRAs during FY 1999-2000. Consequently, the annual tax increment was understated in FY 1999-2000, resulting in the incorrect allocation of revenue and apportionment factors for all jurisdictions, including the ERAF.

Requirements for the apportionment and allocation of the annual tax increment are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's annual tax increment apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

During the fieldwork of this audit, the county began computing and implementing corrections to the increment and apportionment process, which included corrections to all jurisdictions and the ERAF for the affected years.

Recommendation

The county should correct the increment and corresponding revenues and allocation factors for all jurisdictions for FY 1999-2000 and revenue transfers to this year and subsequent years.

FINDING 2— Incorrectly computed unitary and operating nonunitary apportionment

The county incorrectly computed available unitary and operating nonunitary revenues in years that did not increase by 2% or more. The county incorrectly computed reductions in revenues using AB 8 apportionment factors in years when the unitary and operating nonunitary revenues declined. For those years, the law simply requires that the revenues be computed as a pro rata share of revenues received in

the prior year. The county procedure resulted in incorrect unitary apportionment amounts for all jurisdictions for all years since FY 1996-97.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should recompute the unitary and operating nonunitary revenues. The impact of computation error was not material during the audit period. However, since each year's revenue is carried forward to begin the following year's computation, the fiscal impact in subsequent years may be significant.

In addition, the county should establish procedures to ensure that all jurisdictions' revenue is properly computed when growth does not exceed 2% over the preceding year.

**FINDING 3—
Incorrectly
computed ERAF
shift credit**

The county properly implemented the alternate apportionment process in FY 1993-94 year, but it failed to properly compute the shift "credit" for the increased revenue received by school entities for that year. The county understated its ERAF credit by $114,930. The county computed the credit to be $925,773, when it should have been $1,040,703.

Revenue and Taxation Code Sections 97.3(a)(5) and 97.36 provide for a reduction in the amount of the ERAF contribution by a county when the county first implements the alternate method of property tax allocation authorized by the *Revenue and Taxation Code*, Part 8, Chapter 2, commencing with Section 4701. This credit, available only for the first year of implementation, is computed based upon the amount of increased revenue allocated to a qualifying school entity that would not have been allocated if the county had not implemented the alternate method of property tax allocation. A qualifying school entity is a school district, a county office of education, or a community college district that is not an excess tax school entity (i.e., an educational agency for which the state funding entitlement under specified sections of the *Education Code*, as appropriate, is zero).

Recommendation

The county should collect the additional shift credit of $114,930 from the ERAF.

Fresno County (July 1, 1997, through June 30, 2000)

**FINDING 1—
Supplemental
property tax–
Undocumented
administrative
costs**

The county did not document the cost of billing, collecting, and apportioning supplemental taxes to justify the collection of the 5% administrative fee.

Revenue and Taxation Code Section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

The county should provide, for all years of the audit period, documentation of supplemental costs to support the 5% administrative fee collected.

Auditee's Response

> We have compiled documentation related to the audit period which provides justification for the 5% administration fee. In the future, we will accumulate documentation for this fee on an on-going basis.

**FINDING 2—
Improperly
computed unitary
and operating
nonunitary
apportionment**

The county did not properly compute growth for the unitary and operating nonunitary property tax system in FY 1998-99 when assessed valuation exceeded 102% over the preceding fiscal year. The county's computation failed to include ERAF and redevelopment projects in the allocation.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should recompute the unitary and operating nonunitary property tax system to include ERAF and redevelopment projects in the allocation. In addition, the county should establish procedures to ensure that subsequent years' computations are correct when assessed valuation exceeds 102% over the preceding fiscal year.

Auditee's Response

> We agree with the auditor's recommendation that the county should recompute the unitary and operating nonunitary property tax system for the audit period to include ERAF and redevelopment projects in the allocation. The adjustment for the audit period will occur in fiscal year 2001-02. In future years, we will include ERAF and redevelopment projects in the unitary and operating nonunitary allocation.

FINDING 3—
ERAF disaster relief
credit not reversed

The county did not reverse the FY 1992-93 ERAF disaster relief credit for the county and all cities within Fresno County in FY 1997-98 as required by *Revenue and Taxation Code* Section 97.2(e)(1) and (2). Consequently, the county owes the ERAF $468,107 plus growth annually for FY 1997-98 through FY 1999-2000, for a total of $1,404,321, plus growth.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;

- Adjusting the result for growth; and

- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;

- Adjusting this amount by subtracting the FY 1992-93 shift to ERAF;

- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and

- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;

- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);

- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF, and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;

- Adjusting this amount for growth; and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted to growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county should recompute the ERAF shift growth for FY 1997-98 through FY 1999-2000 and repay the ERAF $1,404,321 plus growth. In addition, the county should reverse the disaster relief credit, with appropriate growth, in the subsequent years' ERAF shift calculation.

Auditee's Response

> We acknowledge that the 1992-93 disaster relief credit for the county and all cities within the county was not reversed in 1997-98. We currently are computing the amount to be shifted to ERAF related to 1997-98 through 1999-00. These adjustments will be made in fiscal year 2001-02.

Los Angeles County (July 1, 1997, through June 30, 1999)

**FINDING 1—
Resolution of prior
audit findings**

Findings noted in the prior audit, dated April 30, 1998, except as discussed in Finding 2 below, have been satisfactorily resolved by the county.

**FINDING 2—
Redevelopment
agencies**

The county has had a continuing problem identifying all unsecured parcels within redevelopment agency (RDA) tax rate areas (TRAs) and transferring them to new TRAs created when an RDA is established.

Previous audit reports have noted that parcels with unsecured value which were located within the boundaries of an RDA have often been assigned to TRAs outside of the RDA. This incorrect assignment of unsecured value has resulted in an understatement of revenues due to the RDA from the unsecured roll. Based on discussions with staff in the County Assessor's Office and County Auditor-Controller's Office, these corrections should be handled in the County Assessor's Office.

The auditors were informed during the prior audit that the County Assessor's Office had developed new procedures in FY 1995-96 to identify and properly record unsecured parcels within RDA project boundaries.

Requirements for the apportionment and allocation of property tax to RDAs are found in *Revenue and Taxation Code* Sections 96.4 and 96.5. California Community Redevelopment Law generally entitles a community RDA to all of the property tax revenues that are realized from growth in values from the redevelopment project's inception.

Recommendation

The county should review the recently developed procedures and install appropriate safeguards to ensure that all unsecured parcels within RDA project boundaries are properly identified and recorded in new TRAs.

Auditee's Response

We agree. All five of the occurrences cited by your staff have been corrected."

**FINDING 3—
Educational
Revenue
Augmentation
Fund**

The county properly reversed the ERAF disaster relief revenue for all appropriate cities and the county's General Fund, but did not make corresponding adjustments to TRA factors to correct the growth portion of this adjustment.

The county properly computed a reversal of the Consolidated Fire District ERAF contribution for FY 1992-93, but only adjusted the base revenue for the district and did not compute and transfer revenue retroactively, as required by AB 1589 (Chapter 290, Statutes of 1997). The county also failed to adjust the FY 1993-94 ERAF computation for the fire district to reflect the revenue adjustment for FY 1992-93.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1

through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* of 40% of FY 1991-92 property tax revenues received as adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the amount of the FY 1992-93 per capita shift;

- Adjusting the result for growth; and

- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93 (pre-ERAF), by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;

- Adjusting this amount by subtracting the FY 1992-93 shift to ERAF;

- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and

- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;

- Multiplying the result by the SDAF factor for the district effective on June 15, 1993 (net current-year bailout equivalent);

- For a board of supervisors-governed district, deducting from the net current-year bailout equivalent the amount received from the SDAF in FY 1992-93, or, for an independent district, deducting from the net current year bailout equivalent the amount received from the SDAF, and the difference between the net current year bailout equivalent and the amount contributed to the SDAF;

- Adjusting this amount for growth; and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county should adjust the TRA apportionment factors for all appropriate TRAs to reflect the reversal of the ERAF disaster adjustment for the county and cities.

The county should compute and pay all retroactive FY 1992-93 ERAF contribution amounts due, as a result of AB 1589, from the ERAF to the fire district. The county should also compute corrected FY 1993-94 ERAF amounts retroactively for the fire district and transfer that amount from the district to the ERAF. The FY 1993-94 ERAF computation will require an adjustment to fire district and ERAF TRA growth factors. The SCO estimates the ERAF owes the fire district a net amount of $38,368,590 plus growth for the period of July 1, 1992, through June 30, 1999.

In addition, the county should make the necessary computations for all fiscal years subsequent to the current audit period (beginning with July 1, 1999) and make the appropriate transfers. The SCO estimates the fire district owes the ERAF a net amount of $17,958,310 plus growth for the period of July 1, 1999, through June 30, 2001.

Auditee Response—J. Tyler McCauley, Auditor-Controller

> **Recommendation** – The county should adjust the TRA apportionment factors for all appropriate TRAs to reflect the reversal of the ERAF disaster adjustment for the county and cities.

> **Response** – We see no provision in the code that requires growth be applied to the Educational Revenue Augmentation Fund (ERAF) disaster reversal for county and cities.

> **Recommendation** – The county should compute and pay all retroactive FY 1992-93 ERAF contribution amounts due, as a result of AB 1589, from the ERAF to the fire district.

> **Response** – We agree.

> **Recommendation** – The county should also compute corrected FY 1993-94 ERAF amounts retroactively for the fire district and transfer that amount from the district to the ERAF.

> **Response** – We disagree. With regard to correcting the ERAF calculation for the SDAF replacement amount, we believe the phrase "amount of revenue allocated to that special district" in Revenue & Taxation Code section 97.3(c)(4)(A)(i) may properly refer to a board of supervisors determining the percent share of SDAF funds allocable to a fire district. It follows that the term "allocated" need not only mean

revenue historically distributed, but may also describe the sum resulting from retrospective legislation that changes a fire district's mandated contribution to SDAF.

Auditee Response—Maria Oms, Assistant Auditor-Controller

Finding # 3 of the draft audit report indicates that as a result of AB 1589, the county should compute and pay all retroactive amounts due from ERAF to the Fire District from FY 1992-93 through FY 1996-97. We agree with the recommendation. However, our review of the documentation supporting the amount ERAF owes the Fire District indicates this amount should be increased by $20,286,602. That is, the retroactive amount identified by your staff of $71,956,918 plus growth should be increased by $20,286,602, which is the first year adjustment applied by the County in FY 1997-98.

Consequently, the retroactive amount ERAF owes the fire district is $92,243,520 plus growth. This amount does not consider a change to the ERAF calculation for the SDAF replacement amount.

SCO Comments

The SCO acknowledges that there is no growth computation of the disaster adjustment amounts for the county and cities for FY 1992-93 through 1996-97. However, since Los Angeles County has computed the ERAF at the TRA level to include it in the annual tax increment process, any substantial change in the base value, such as the exclusion of the disaster amounts for FY 1992-93 or the reinstatement of those amounts for FY 1997-98, would require that an appropriate adjustment be made to the TRA factors to compute proper incremental growth for all future years.

The audit finding states that the computation must be based on the actual amounts received by the county fire fund from the SDAF in FY 1992-93, which the SCO believes is consistent with the clear intent of *Revenue and Taxation Code* Section 97.3(c)(4)(A). That section expressly requires the county auditor to determine on or before September 15, 1993, the "amount of revenue allocated" in FY 1992-93 to a special district from the SDAF. Thus, the statute's intent was that the determination be made after the close of FY 1992-93 when there would be a record of the exact amount received from the SDAF, rather than making the determination based on an estimate made before the commencement of FY 1992-93. The term "allocated" should be understood in the context in which it is used. The county contends it could be construed to mean "the sum resulting from retrospective legislation that changes a fire district's mandated contribution to SDAF." However, when considered in the context of the determination to be made after the close of the fiscal year, the only reasonable interpretation is that it refers to the amount that had actually been distributed from the SDAF.

The audit finding has been adjusted to correct the computation error noted in Ms. Oms' letter.

Madera County (July 1, 1995, through June 30, 2000)

**FINDING 1—
Incorrectly
computed unitary
and operating
nonunitary
apportionment**

The county did not properly compute growth for the unitary and operating nonunitary property tax system in all fiscal years when the assessed valuation exceeded 2% over the preceding year. County computations of excess revenue failed to include redevelopment projects.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should recompute the unitary and operating nonunitary property tax revenue for all years to include redevelopment projects. The county should establish procedures to ensure that all jurisdictions are included when growth exceeds 2% over the preceding year.

Auditee's Response

> The County concurs with this finding and has already recomputed the unitary and operating nonunitary tax revenue for all years to include redevelopment projects and has established procedures to ensure that all jurisdictions are included when growth exceeds 2% over the preceding year.

**FINDING 2—
Incorrectly
computed ERAF
shift credit**

The county properly implemented the alternate apportionment process in FY 1993-94, but only computed the ERAF credit adjustment for revenues received through May 31, 1994, that were attributable to school entities. Revenues received by Madera County from June 1 through June 30, 1994, that were attributable to school entities, totaled $395,429.

Revenue and Taxation Code Sections 97.3(a)(5) and 97.36 provide for a reduction in the amount of the ERAF contribution by a county when the county first implements the alternate method of property tax allocation authorized by *Revenue and Taxation Code*, Part 8, Chapter 2, commencing with Section 4701. This credit, available only for the first year of implementation, is computed based upon the amount of increased revenues allocated to a qualifying school entity that would not have been

allocated if the county had not implemented the alternate method of property tax allocation. A qualifying school entity is a school district, county office of education, or community college district that is not an excess tax school entity (i.e., an educational agency for which the state funding entitlement under specified sections of the *Education Code*, as appropriate, is zero).

Recommendation

The county should repay the excess shift credit of $395,429 to the ERAF.

Auditee's Response

> The County does not concur with this finding. The period under audit was July 1, 1995, through June 30, 2000. The calculation of the ERAF credit adjustment was performed during the 1994-95 fiscal year, one fiscal year prior to the audit period. Fiscal year 1994-95 was audited by the State Controller's Office in early 1997. In the report for that audit, issued May 29, 1997, there were no findings concerning calculation of the ERAF credit adjustment. I believe that the State Controller's Office exceeded the scope of the current audit by including calculations prior to the audit period.

> Secondly, I do not concur with the interpretation that forms the basis for this finding. It is my understanding that it was the intent of the legislation to allow the County to reduce its ERAF contribution in 93-94 by the additional taxes the schools received in 93-94 due to the County's change to the Teeter Plan method of property tax distribution. That additional amount was to be computed by subtracting from the amount of taxes the schools received in 93-94, under Teeter, the amount they would have received, in 93-94, under the old method. Under the old method, the schools would not have received, in 93-94, the taxes collected in June of 1994. Beginning with the first apportionment of taxes after Proposition 13, Madera County has always allocated June tax collections in the subsequent fiscal year. I believe that Madera County's calculation of the ERAF credit was done in accordance with the way taxes had always been apportioned in the County and that was the intent of the legislation.

> Madera County is currently in the process of obtaining legislative certification of our calculation of the ERAF credit and does not intend to take action to correct this finding pending that certification.

SCO Comments

During the prior audit, the SCO did not audit the ERAF shift credit. The SCO has a responsibility to determine that calculations related to the apportionment and allocation of property tax revenues are correct.

The term "allocated" should be construed as having reference to tax revenues for schools attributable to FY 1993-94 collections. Regardless of whether such revenues had been disbursed to schools or remained in the county's treasury, the revenues reduced the amount of county funds needed for the FY 1993-94 buy-out and, in turn, reduced the county's ERAF credit.

If the Teeter buy-out credit provisions continuously applied each year, perhaps there would be an argument that the accounting cycle used by Madera County substantially satisfied the objectives of the law; i.e., the figures would "even out" over a period of years.

However, the operation of *Revenue and Taxation Code* Section 97.3(a)(5) is restricted to a one-time credit for increased revenues allocated to schools for FY 1993-94. In essence, Madera County's position on this issue substitutes two different fiscal years in place of FY 1993-94. The language of the statute reflects an intent that calculations be confined to FY 1993-94 for counties electing to claim the buy-out credit.

In effect, Madera County did not follow the statute as enacted by the Legislature. The county was not required to claim the Teeter buy-out credit. If it elected to do so, it was required to compute the credit in accordance with the statute regardless of its existing accounting procedures. In brief, Madera County was required to conform to the law, rather than the law conforming to the county's selected accounting processes. The finding remains as written.

Monterey County (July 1, 1996, through June 30, 2000)

FINDING 1— Supplemental property tax

An error was noted in the methodology used to compute supplemental apportionment factors for FY 1996-97 through FY 1999-2000. The county improperly excluded multi-county educational entities from the apportionment process.

The legal requirements for supplemental roll property tax apportionment and allocation are found in *Revenue and Taxation Code* Sections 75.60 through 75.71 and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property to the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

The county should correct the supplemental apportionment methodology.

Auditee Response

> Monterey County has corrected the supplemental apportionment methodology.

FINDING 2— Educational Revenue Augmentation Fund

The ERAF shift for FY 1997-98 was not computed properly. ERAF shifts from the county, one city, and several special districts were understated for the year while six cities and a few special districts overcontributed to the ERAF. These errors resulted in a net underpayment to the ERAF of $138,774 for FY 1997-98 only.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

Recommendation

The county should correct all ERAF amounts for FY 1997-98 and transfer the $138,774 underpayment into the ERAF.

Auditee Response

> Monterey County correctly calculated the ERAF shift for all years under audit except for FY 1997-98. Monterey County, Cities and Special Districts paid $31,846,431 for the ERAF shift in FY 1997-98. The underpayment of $138,774 represents less than half of one percent (.435%). Although the County agrees that an error in the ERAF calculation occurred, we believe this amount is not material and therefore should not be included as an audit finding.

SCO Comment

The SCO concurs that the amount of the underpayment is small in relation to the entire county ERAF shift. However, the underpayment resulted in the State's General Fund providing additional support to schools that would not have been made in the absence of the error. The finding remains as written.

Sacramento County (July 1, 1996, through June 30, 2000)

No findings.

San Bernardino County (July 1, 1997, through June 30, 2000)

FINDING 1— Incorrectly calculated and distributed ATI

The county recomputed the ATI factors for all jurisdictions in all TRAs each year, causing the factors to be inconsistent from year to year. *Revenue and Taxation Code* Section 96.5 states that the TRA apportionment factors should not change, except as needed for jurisdictional changes. The county's methodology of adjusting the ATI factors annually results in different increment computations for most jurisdictions. The differences noted were not significant during the audit period. However, since the revenues are carried forward and compounded each year, the differences may become significant.

Requirements for the apportionment and allocation of the ATI are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax

increment is then multiplied by the jurisdiction's annual tax increment apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

The county should adjust only the ATI factors for jurisdictions in TRAs as necessary to accommodate jurisdictional changes.

Auditee's Response

> While we agree with the State Controller's Office's (SCO) interpretation of Revenue and Taxation code 96.5, the significance of the recommended change should be noted. A test was conducted to determine the impact of freezing the ATI factors. A sample of agencies was selected and the annual tax increment was calculated with the TRA factors frozen over a period of four years. This resulted in changes in allocation of .05% or less for each of the agencies in the sample over the four-year period or about .0125% or less each year. Although implementing this change will be at considerable cost to the county, we expect to have our system corrected within the next three years.

FINDING 2— Incorrectly transferred revenues for jurisdictional changes

For some of the samples selected, the assessed value (AV) was not transferred from the existing (old) TRAs to the resulting (new) TRAs when the new TRAs were formed. As a result, the increment was overstated because the calculation is based on the difference between current value and prior value. This error appears to be an isolated incident and not a systemic problem since it did not occur in all jurisdictional changes.

The legal requirements for jurisdictional changes are found in *Revenue and Taxation Code* Section 99. A jurisdictional change involves a change in organization or boundaries of local government agencies and school districts. Normally, these are service area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, the local government agencies are required to negotiate any exchange of base-year property tax revenue and annual tax increment. After the jurisdictional change, the local agency whose responsibility increased receives an additional annual tax increment, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

The county should correct the jurisdictional changes, so that the correct AV is transferred from the existing (old) TRAs to the resulting (new) TRAs when the new TRAs were formed. The county should also establish procedures to ensure that these errors do not re-occur.

Auditee's Response

> All jurisdictional changes done in the county are in accordance with R & T code 99(d), which allows a county to adopt a master property tax transfer agreement. The county agreement specifies that a given dollar

figure be transferred. Jurisdictional changes are made effective the year they are recognized by the State Board of Equalization. This would be the year that the changes appear on the tax rate area chart that is passed annually by the State to the County. The changes referred to in the audit report were finalized in 1997-98. Since these changes were made after December 1, 1997 they were not recognized by the state for the 1998-99 fiscal year. They were reflected on the tax rate area chart from the State Board of Equalization for the 1999-2000 fiscal year. There is no provision in the law to calculate two years worth of increment in these instances. These jurisdictional changes were made effective for the 1999-2000 fiscal year and given one year of growth. . . .

The instances where the AV was not transferred from the old TRAs to the new TRAs have been corrected. The allocated amounts were corrected and brought forward and incorporated in the 2001-2002 allocation. The flaw in our processing that caused this has been identified and steps have been put in place to prevent this from occurring in the future.

SCO Comments

Upon further review, the SCO concurs with the county's position that, during the creation of three new TRAs, the county did transfer revenues correctly from the existing (old) TRAs to the resulting (new) TRAs. Consequently, the first paragraph of Finding 2 in the draft report, which addressed this issue, has been removed from the final report.

San Mateo County (July 1, 1995, through June 30, 1999)

Findings noted in the prior audit, dated March 31, 1997, except as discussed below, have been satisfactorily resolved by the county.

In the previous SCO audit dated March 31, 1997, the SCO advised the county to recompute the unitary and operating nonunitary base factors due to errors in the establishment of the base revenue. The SCO recommended that the county re-establish the base revenue amount in accordance with *Revenue and Taxation Code* Section 100(e)(3). In addition, the county was advised to include RDAs in the process and apportion revenue in excess of 102% using modified AB 8 factors.

In the re-establishment of the base year revenue amounts, the county used actual unitary revenues apportioned on December 10, 1988, and April 14, 1989, rather than developing the unitary base revenue amount by determining each jurisdiction's ratio using assessed valuations per TRA multiplied by the general tax rate.

The county corrected the unitary system by including RDAs in the system process. The inclusion of the RDAs resulted in negative apportionment factors for four jurisdictions. In addition, the county corrected the computation of revenues in excess of 102% and it appears that this process is now in compliance with the *Revenue and Taxation Code*.

During the current audit fieldwork, the county corrected the base revenue and apportionment factors for the unitary and operating nonunitary apportionment process.

**FINDING 2—
Calculation and
distribution of ATI**

The county did not adjust the AB 8 base revenue correctly for the removal of the unitary and operating nonunitary base revenues. The error caused an overstatement of AB 8 base revenue by $78,745 and a corresponding understatement to the unitary and operating nonunitary base revenue.

Requirements for the apportionment and allocation of the annual tax increment (ATI) are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's annual tax increment apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

During the current audit fieldwork, the county corrected the AB 8 base revenue and apportionment factors.

**FINDING 3—
Unitary and
operating
nonunitary
apportionment**

The county (1) did not include the ERAF in the apportionment process when assessed valuation exceeded 102% of the preceding year, (2) distributed the SDAF base revenue to all jurisdictions rather than to the contributing agencies when the SDAF was dissolved, and (3) computed the countywide average tax rate by including unsecured revenue in the formula.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

During the current audit fieldwork, the county corrected the unitary and operating nonunitary apportionment factors and the formula for the countywide average tax rate.

**FINDING 4—
Educational Revenue
Augmentation Fund**

The county incorrectly computed the ERAF shift growth by excluding redevelopment agencies' pass-through amounts from the growth factor in contributing agencies.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

During the current audit fieldwork, the county corrected the ERAF shift growth factors.

Recommendation

The county should quantify the amount of the error and make appropriate transfer into the ERAF. In addition, the county should establish procedures to ensure that redevelopment agency pass-through amounts are included in growth factor computations.

Shasta County (July 1, 1995, through June 30, 2000)

No findings.

Trinity County (July 1, 1994, through June 30, 2000)

**FINDING 1—
Unitary and
operating
nonunitary
apportionment**

The county did not properly compute growth for the unitary and operating nonunitary property tax system in FY 1999-2000 when assessed valuation exceeded 102% over the preceding year. The county's computation failed to include all taxing jurisdictions, including the ERAF.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should recompute FY 1999-2000 unitary and operating nonunitary property tax system to include all taxing jurisdictions, including ERAF. In addition, the county should establish procedures to ensure that subsequent years' computations are correct when assessed valuation exceeds 102% over the preceding year.

Auditee's Response

> The County has made the necessary adjustments to reflect the proper allocation of 1999-2000 unitary and nonunitary taxes. Procedures have been put into place to include the 1.02% growth rule.

FINDING 2— Educational Revenue Augmentation Fund

The county did not compute ERAF growth when assessed valuation changed from the preceding year in FY 1994-95 and subsequent fiscal years. The errors resulted in a net underpayment to the ERAF of $206,052 (see Schedule 1).

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;

- Adjusting the result for growth; and

- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;

- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;

- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;

- Multiplying the result by the SDAF factor for the district effective on June 15, 1993 (net current-year bailout equivalent);

- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent, or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;

- Adjusting this amount for growth; and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county should recompute the ERAF contribution amount for all agencies and transfer $206,052 to the ERAF.

Auditee's Response

The County has made the necessary adjustments to reflect the proper allocation of property taxes.

However, we disagree with the recommendation for the following reasons:

1. The SCO is charged by Government Code Section 12468(c) to conduct an audit every five years. Your audit was conducted in the fall of 2000 and went back to July of 1994. Had the SCO complied with the Code, this error would have been discovered much sooner, and the correction made when the monetary amounts involved were much smaller.

2. In 1999, David Nelson, the County's Chief Deputy Auditor, forwarded our ERAF apportionment calculations to Greg Brummels of your office for review. Since the calculations had never been reviewed by the SCO, it was our intention to verify that apportionments were being done correctly. Even after repeated telephone calls, we did not receive a response. Again, had the SCO

taken the time to review the calculations, this error would have been discovered much sooner, and the correction made when the monetary amounts involved were much smaller.

3. Finally, Trinity is a small county with limited resources, and we cannot afford such a large payment.

Auditor's Comment

The SCO acknowledges that the audit covered six rather than five years in reviewing the county's calculation. Nevertheless, the delay does not alleviate the county's responsibility for making the proper allocation of property taxes.

Tulare County (July 1, 1997, through June 30, 2000)

**FINDING—
Overallocation to the
Educational Revenue
Augmentation Fund**

The county incorrectly computed the disaster relief adjustment for the ERAF shift because the county did not include growth. For FY 1993-94 through FY 1996-97, the county computed the disaster relief adjustment to be $711,320 rather than $822,816. Consequently, the county overallocated $111,496 in revenue to the ERAF (Schedule 1).

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;

- Adjusting the result for growth; and

- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;

- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;

- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and

- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;

- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);

- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;

- Adjusting this amount for growth; and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted to growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county should reduce the ERAF shift amounts by $111,496 on a one-time basis for the affected agencies.

Auditee's Response

> As recommended, I will reduce the ERAF shift amounts by $111,496, and distribute the amounts to the cities and County using the schedule provided by your auditor. Based on the representation of the field audit supervisor in the exit conference, by complying with the recommendation in the audit finding, this now closes the period July 1, 1997, through June 30, 2000, to future audits by the State Controller's Office.

> Unless required by Government Code, I respectfully decline to issue a representation letter regarding this audit or any future audits not requested by the County of Tulare. I do not feel it appropriate, or required, to sign a representation letter for audits not initiated by the County.

SCO Comments

The SCO concurs that the audit period is closed, but only to the extent that all relevant documentation supporting the county's property tax apportionment and allocation system was provided to SCO auditors during the course of the audit and that fraud was not involved. As noted above, the county is not willing to provide the SCO with a representation letter stating that it provided the auditors with all relevant documentation supporting the county's property tax apportionment and allocation system.

Tuolumne County (July 1, 1993, through June 30, 1999)

**FINDING 1—
Resolution of
prior audit
findings**

Findings noted in the prior audit, dated August 4, 1994, as discussed below, had not been satisfactorily resolved as of the start of the current SCO audit:

1. The county incorrectly computed the base revenues and tax rate area factors;

2. The county incorrectly modified the tax rate area factors for jurisdictional changes; and

3. The county incorrectly apportioned the unitary and operating nonunitary property tax revenues.

During the current audit, the county corrected all of the above findings.

**FINDING 2—
Supplemental
property tax**

The county incorrectly apportioned the supplemental property tax revenues (billing amount) to the jurisdictions by removing the Sonora Redevelopment Agency revenue twice. First, the Sonora Redevelopment Agency revenue was removed from the gross amount when computing the apportionment factors. Then the revenue was again removed from the participating agencies using Teeter percentages to arrive at the net apportionment factors.

The legal requirements for supplemental roll property tax apportionment and allocation are found in *Revenue and Taxation Code* Sections 75.60 through 75.71 and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property to the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

During the current audit, the county corrected the apportionment procedure.

**FINDING 3—
Unitary and
operating
nonunitary
apportionment**

The county incorrectly computed the unitary and operating nonunitary property tax system for FY 1996-97, FY 1997-98, and FY 1998-99.

In FY 1996-97, the county incorrectly computed the apportionment because: (1) the assessed valuation used did not agree with information provided by the State Board of Equalization (BOE); (2) the gross levy was computed as 98.26% of prior-year revenue; and (3) the county incorrectly computed the apportionment when the growth in assessed valuation exceeded 102% of the prior-year amount.

For FY 1997-98 and FY 1998-99, the gross levy was computed as 92.39% and 97.53%, respectively, of prior-year revenue, instead of 1% of assessed valuation as provided by the BOE.

In addition, for FY 1996-97, FY 1997-98, and FY 1998-99, the county excluded the RDA from the apportionment process.

During the current SCO audit, the county corrected the system to apportion the unitary and operating nonunitary revenues.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

When computing the unitary and operating nonunitary apportionments, the county should ensure that the total amount allocated agrees with the information received from the State Board of Equalization.

**FINDING 4—
Property tax
administrative
costs**

The county excluded the ERAF AB 8 factor when computing the administrative allocation factors.

Requirements for the reimbursement of county property tax administrative costs are found in *Revenue and Taxation Code* Section 95.3. county property tax administrative costs are incurred by the assessor, tax collector, assessment appeals board, and auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

The county should include the ERAF AB 8 factor when computing the administrative allocation factors.

FINDING 5— Educational Revenue Augmentation Fund

The county incorrectly computed the ERAF shift and, therefore, understated the ERAF shift by approximately $1,110,674, as of June 30, 1999. In FY 1992-93, the county did not correct the base revenues and tax rate area factors, as recommended by the SCO in the previous audit, dated August 4, 1994. In FY 1993-94, the county incorrectly computed the additional amounts due to/from the ERAF for all local government agencies. In addition, the FY 1992-93 ERAF shift amount for these agencies was not carried forward in FY 1993-94. All of these errors were carried forward in subsequent fiscal years.

During the current SCO audit, the county corrected property tax allocations relating to the ERAF as of June 30, 2000, but did not transfer the amount due to the ERAF as of June 30, 1999, totaling approximately $1,110,674 (see Schedule 1).

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* of 40% of FY 1991-92 property tax revenues received as adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing FY 1992-93 ERAF shift by FY 1992-93 per capita shift;

- Adjusting the result for growth; and

- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;

- Adjusting this amount by subtracting FY 1992-93 shift to ERAF;

- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and

- Adding this amount to FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting FY 1992-93 ERAF shift for the district from FY 1992-93 property tax allocation;

- Multiplying the result by the SDAF factor for the district effective on June 15, 1993 (net current year bailout equivalent);

- If a board of supervisors governed district, deducting from the net current year bailout equivalent the amount received from the SDAF in FY 1992-93, or if an independent district, deducting from the net current year bailout equivalent, the amount received from the SDAF, and the difference between the net current year bailout equivalent and the amount contributed to the SDAF;

- Adjusting this amount for growth; and

- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county should transfer approximately $1,110,674 into the ERAF.

Auditee Response

> The majority of the correction pertains to AB 860 calculation for the fire districts and or community service district providing fire services. The correct calculation should have reflected the 1992-93 shift. Although we agree with the correction, except for one fire district, we do not agree with the request for prior year repayments. These repayments would cause an adverse hardship on all of the fire districts and one community service district. See attached ERAF Repayment Schedule for review.

> Our review of the calculations determined that an adjustment of $8,945 was not reflected in the 93-94 adjustments for one of the fire districts. This would result in reduction of $59,105 for Finding # 5.

SCO Comment

The SCO acknowledges the $59,105 error in the ERAF shift computation for one fire district, as presented in the draft report. Accordingly, this finding has been updated to reflect approximately $1,110,674 rather than $1,169,779 as the amount due the ERAF.

Copies of the audit reports referred to in this report may be obtained by contacting:

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250-5874

http://www.sco.ca.gov

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